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As I see

RANDOM THOUGHTS ON THE REAL ESTATE SITUATION AT THE END OF MAY 1951

I have received a number of queries recently asking whether in my opinion the next real estate depression was about to start. The drop in the stock market from the first part of May until a few days ago was quite rapid and sharp. Inventories, in spite of shortages of many types of raw materials, have been accumulating, particularly in the durable goods field. Price wars have carried the selling prices of some types of department store merchandise to levels below cost. Automobile dealers have been unable to dispose in many communities of their allotments of new cars, and in some cases have filled their warehouse space and have had to store the surplus in open fields. Quite by accident on my way to work the other morning I came across a field of this sort containing 250 brand new cars.

In the real estate field, the unpegging of the government bond market and the rise in interest rates on government bonds has dried up mortgage funds formerly available through life insurance companies and banks. Regulation X, together with the shortage of mortgage funds, is starting to bite deeply into construction volume. Construction costs have continued to rise, providing a further deterrent to building.

Applications for FHA insurance have been dropping rapidly during the past few months. FHA mortgages which formerly could be sold at a premium are now faced with a small market. The money to finance veterans' loans is scarce, as the VA is attempting to maintain the unrealistic rate of interest, assuming that it is doing the veteran a service. If I were a veteran looking for a loan at the present time, I would feel more kindly toward the VA if I could get a loan at $\frac{1}{2}$% higher interest rather than be told of the great benefit being conferred on me by holding down the interest rate at which I could not secure a loan.

The releases of the United States Census on the number of vacant dwelling units in nonfarm areas would also tend to show that the housing shortage has been practically dissipated and that we probably have a potential oversupply. Census figures show 6.5% of our dwelling units vacant on April 1, 1940, and 7.01% vacant on April 1, 1950. In 1940 practically all of those vacant were for rent; in 1950 practically none of those vacant were for rent due to rent control provisions.

Two weeks ago I spoke in Los Angeles in the morning and drove around for about an hour in the afternoon. Up until a few months ago rents in Los Angeles were controlled. Decontrol was fought bitterly in the courts by Tighe Woods. In the short time I drove around I saw a large number of "for rent" signs on apartments and dwelling units. While rents are still rising both in controlled and in uncontrolled cities, the

rise in uncontrolled cities where controls were done away with some time ago is now quite slow.

Real estate activity is gradually subsiding and inasmuch as a large part of it during the past year has consisted in the sale of new properties, the drop in new building is bound to have a still further shrinking effect on the general level of transfers.

What do all of these factors indicate for the future? Are we again at a 1929 level, sliding off into a period similar to the thirties?

While no one can give a categorical answer to a question of this sort, I have listed below what I think are the important factors which a person should keep in mind in trying to estimate the future as it involves real estate.

1. Undoubtedly we have just come through the larger part of one of the greatest real estate booms in history. That is apparent to anyone looking at the long real estate activity chart published by this company. Real estate activity went higher in relationship to our computed normal than it has ever gone at any time in the past. The historical pattern of the past has been for a boom of this sort to be followed by a sizable depression in which real estate activity would shrink as most real estate investments became frozen.

2. During the boom we have just come through we have experienced a tremendous inflation, not only in real estate values but in the prices of practically all commodities and services. In each case where this has been true in the past the depression which followed caused foreclosures to rise rapidly to considerable heights, as real estate was financed at the inflated level and the pay-offs on the loans were not sufficiently rapid to keep ahead of falling values. There can be no question of the fact that a great deal of wild financing has accompanied the boom through which we have just passed. Eighty, 90 and 100% loans have been common, with the strong probability that many 110 and 120% loans have been made.

3. Rent control has expanded the demand for housing, as many persons living in controlled units have been able to afford a larger number of square feet of dwelling space and a higher quality of space than they could secure in a free market unsubsidized by their landlords. This has expanded the demand for housing and has concealed the fact that we have added to our housing supply a larger number of dwelling units than we have added new families.

4. In 1950 we constructed more dwelling units in the United States than we have ever built before in a 12-month period. Since April 1950 we have added about 3% to the number of dwelling units in existence. In April 1950 the Bureau of the Census found a larger number of vacant dwelling units than they found in April 1940, when it is generally conceded no housing shortage existed. A shrinkage in demand to a more normal level could bring about a considerable surplus of dwelling units.

5. Construction costs have continued upward and there does not seem to be too great a chance of any sizable drop. There may be some drops late this fall due to the reduced volume of residential construction, as the probable level of building will be only 50% of the level of a year ago. This would tend to release the less efficient con-

struction workers, leaving only the more efficient who would normally work harder because of the change in employment conditions. It would also ease the shortages of some construction materials used primarily on residential construction which does not require critical raw materials. Undoubtedly lumber will be easier to get at probably a lower price this fall than in recent months. It should be kept in mind, however, in considering this possibility of a drop in construction costs that total construction of all types will exceed the level of a year ago. In place of bringing wholesale unemployment in the building field there will probably be many shifts on the part of building labor from residential construction to other types of construction activity. This will prevent any great surplus of construction materials which might otherwise have a sharp depressing effect on material prices.

6. The heavy government spending for rearmament by late fall will be pumping currency and credit into the business stream at a sufficient rate to have a stimulating effect and will probably offset some of the deflationary factors listed above.

7. The similarity of the present situation to the inflated boom which followed the Civil War and a similar boom which followed World War I cannot be pressed too far. While the Civil War boom was financed with greenbacks, the United States returned to the gold standard at the pre-Civil War value of gold in 1878, and the United States remained on the gold standard during the boom of the twenties until the early part of the thirties. In 1933, however, we left gold and went on a so-called "managed currency" basis. "Managed currencies" are not new; they have been tried hundreds of times in practically all countries of the world. In each case they have proved that a better term would probably be "mismanaged currencies." Money management has generally resulted in progressive loss of purchasing power of the monetary unit.

8. Over the long period there has been a tendency for the values of existing properties to follow the levels of replacement cost. The relatively slight chance of radical drops in construction costs should have a bolstering effect on an otherwise declining real estate market, and the chance for further inflation makes the holding of large amounts of liquid assets at the present time relatively inadvisable.

It seems to me, therefore, that I would change the general advice given quite frequently on the long charts published by this organization of selling real estate before the boom is over and of holding cash, bonds or mortgages during the shrinking period. I would, of course, dispose of all inefficient properties, but I would probably hold the best properties and would attempt at the present time to reduce the indebtedness on them to a minimum. This is a time for conservatism in investments as it is rather difficult to tell which way the economic cat is apt to jump. The person who carries clear real estate into the next depression will probably find that the sales value of his real estate, should he be forced to liquidate, will have a purchasing power on that market not greatly lower than the purchasing power he could secure by selling today. Of course, the ideal policy would be to carry the property through into the following boom.

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I have received such an unusual response to "As I See It Rent Controls Should Be Abolished" that I have devoted some time to the practical and political questions involved.

A study of the probable line-up in the Senate and the House on rent control legis-

lation has been made by our office based on past voting records and on probable changes of attitude which may have been brought about by decontrol of the territory from which the Senator or the Representative comes. This sort of a study looks quite favorable from the standpoint of the possibility of defeating rent control when it comes to a vote in the near future.

Let us examine together the figures on both the Senate and the House.

There are 96 Senators. Based on the voting record of the past, 40 of these Senators will probably vote for a continuation of rent control. In 1950 rent control was submitted to a vote in the Senate on two different occasions, with 42 Senators voting against it either once or twice. There are six Senators in addition who voted for control in 1950, but whose States are now decontrolled completely. These Senators would probably feel no compulsion now to vote for a continuation of controls. In addition, eight Senators who voted for rent control in 1950 come from States which are practically decontrolled, as there are only a very small number of small areas in the State under control.

In view of the foregoing it looks as if there might be a very good chance of defeating rent control in the Senate.

The House of Representatives has 435 members. Based on past performance and voting record, we would expect 171 of these Representatives to vote for rent controls. During 1950, 199 Representatives voted against rent control either once or twice. In addition, 65 Representatives who voted for rent control in 1950 come from Congressional districts which are now decontrolled, and these Representatives in a majority of cases would probably not feel any local compulsion to continue rent controls.

In summary, if the 42 Senators who previously voted against rent control could be counted on to vote against it again, with the possibility of getting at least a portion of the vote of the 14 Senators who previously voted for rent control but whose States have since been freed from Federal controls, a maximum of 56 votes out of a total of 96 could be secured. If the 65 Representatives who voted for rent control in 1950 but whose districts have since been decontrolled should vote against rent control in 1951, together with those Representatives who voted against it in 1950, a total number of 264 Representatives could carry the day against the 171 who, on the basis of past performance, are almost certain to vote for its continuance. This would look as if there is considerable chance that rent control may not be renewed in spite of the strong efforts of the Administration to hold it.

While our organization has never propagandized for any cause (as we have conceived our function to be the preparation of analytical material on questions involving real estate), we feel quite strongly that rent control is against all of the fundamentals of sound economics and that it should be abolished.

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